

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

-----In the Matter of-----) DOCKET NO. 2008-0274
)
 PUBLIC UTILITIES COMMISSION)
)
 Instituting a Proceeding to)
 Investigate Implementing a)
 Decoupling Mechanism for Hawaiian)
 Electric Company, Inc., Hawaii)
 Electric Light Company, Inc., and)
 Maui Electric Company, Limited.)

PUBLIC UTILITIES
COMMISSION

2009 SEP -8 P 4:02

FILED

THE DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT, AND TOURISM'S
OPENING BRIEF

AND

CERTIFICATE OF SERVICE

MARK J. BENNETT
Attorney General of Hawaii

DEBORAH DAY EMERSON
GREGG J. KINKLEY
Deputy Attorneys General
Department of the Attorney General
State of Hawaii
425 Queen Street
Honolulu, Hawaii 96813
Tel. 586-1180

Attorneys for the Department of
Business, Economic Development,
and Tourism

TABLE OF CONTENTS

<i>Background</i>	2
I. Will decoupling achieve Hawaii's objectives?	5
II. Decoupling Mechanics: How well does the HECO Companies' decoupling design (RBA) achieve Hawaii's objectives?	10
III. Revenue Adjustment Mechanism (RAM): How well does it achieve Hawaii's objectives?	14
IV. Revenue per Customer Mechanism and Other Alternatives: How Well Do They Achieve Hawaii's Objectives?	35
V. Energy Cost Adjustment Clause Amendment: What are its Advantages and Disadvantages in Terms of Hawaii's Objectives?	43
VI. What review processes and safeguards should the Commission consider?	44
VII. Legal Issue	50
<i>Conclusion</i>	53

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

-----In the Matter of-----)	DOCKET NO. 2008-0274
)	
PUBLIC UTILITIES COMMISSION)	
)	
Instituting a Proceeding to)	
Investigate Implementing a)	
Decoupling Mechanism for Hawaiian)	
Electric Company, Inc., Hawaii)	
Electric Light Company, Inc., and)	
<u>Maui Electric Company, Limited.</u>)	

**THE DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT, AND TOURISM'S
OPENING BRIEF**

The Department of Business, Economic Development, and Tourism ("DBEDT"), by and through its Director ("Director") in his capacity as the Energy Resources Coordinator ("ERC"), through the undersigned Deputy Attorney General, hereby submits to the Hawaii Public Utilities Commission ("Commission" or "PUC") its Opening Brief in the instant docket, an investigatory proceeding on implementing a decoupling mechanism for Hawaiian Electric Company, Inc. ("HECO"), Hawaii Electric Light Company, Inc. ("HELCO"), and Maui Electric Company, Limited ("MECO") (collectively, the "HECO Companies").

Background

By Order issued on October 24, 2008, the Commission initiated the above captioned docket, Docket No. 2008-0274, to examine implementing a decoupling mechanism for the HECO Companies that would modify the traditional ratemaking framework by removing the link between the utilities' earnings and kilowatt-hour sales. The Commission's Order initiating the investigation cited the Energy Agreement ("Agreement") entered into between the State of Hawaii and the HECO Companies on October 20, 2008 under the auspices of the Hawaii Clean Energy Initiative ("HCEI"), as the basis for initiating this docket and designated the HECO Companies and the Consumer Advocate ("CA") as parties to the docket, being signatories to the Agreement. To expedite the process, the Commission directed the CA and the HECO Companies to submit¹ to the Commission a joint proposal on decoupling that addresses the factors identified in the Energy Agreement within sixty days from date of the PUC Order.

On December 3, 2008, the Commission granted intervention in this proceeding to seven parties, including DBEDT¹. On January 21, 2009, the Commission issued a Scoping Paper titled "Decoupling Utility Profits from Sales: Design Issues and Options for the Hawaii Public Utilities Commission" prepared by

¹The intervenors in this docket include DBEDT; Hawaii Holdings LLC, dba First Wind Hawaii (First Wind); Haiku Design and Analysis (HDA); Hawaii Renewable Energy Alliance (HREA); Life of the Land (LOL); Hawaii Solar Energy Association (HSEA); and Blue Planet Foundation.

the National Regulatory Research Institute (NRRI). The Scoping Paper discussed the driving forces for considering decoupling and identified issues, as well as four basic approaches to decoupling, including:

- (1) Lost earnings tracker, similar to the lost margin cost recovery mechanism adopted by the Commission in the mid-1990s when the HECO Companies were mandated to design and implement demand-side management programs, and in effect from 1996 to 2006;
- (2) Total sales adjustment approach, which adjusts a utility earnings for any changes in total sales, similar to the concept supported in principle by the Parties to the Energy Agreement;
- (3) Sales per customer adjustment, similar to the total sales adjustment approach except that it is based on a predetermined average sales per customer normally set in a rate case, and is multiplied by the number of customers during the non-rate case years to determine the revenue adjustment; and
- (4) Straight-fixed variable rate design which, as described in the scoping paper, appears to be a cost-based rate design which aligns the rates or

charges to the utilities' costs (i.e., recover fixed costs from fixed charges such as the customer charge or demand charge, and recover the variable costs from the variable charges such as the energy rates).

In addition to the decoupling approaches, the Scoping Paper also identified some implementation decisions, such as the calculation of lost revenues, lost earnings, and fixed costs; frequency of the decoupling adjustment; and allocation of the decoupling earnings adjustment.

On the same day, January 21, 2009, the Commission issued its Procedural Order approving with modification the Parties' proposed Stipulated Procedural Order filed on December 26, 2008, which includes the procedural schedule and the issues to be addressed in the docket. On January 30, 2009, the CA and the HECO Companies separately filed their proposed decoupling mechanisms. Pursuant to the procedural schedule approved by the Commission, the Parties submitted their informal information requests to the CA and the HECO Companies on their individual decoupling proposals on February 13, 2009, followed by a technical workshop conducted by the HECO Companies on February 27, 2009. The Parties filed their Opening Statements of Position ("OSOP") on March 30, 2009, and their Final Statements of Positions ("FSOP") on May 11, 2009.

On June 16, 2009, the Commission issued its Hearing Order establishing the hearing procedure for the panel hearing scheduled for June 29 - July 2, 2009 pursuant to the procedural schedule. In its Hearing Order, the Commission identified six major panel areas of issues requiring Commission decisions, replacing the issues set forth in the Commission's January 21, 2009's Procedural Order. Accordingly, in an effort to help in the Commission's deliberations, DBEDT's Opening Brief herein is structured to provide comprehensive discussions and responses to the questions raised under the six major subject areas identified in Exhibit A of the Commission's June 16, 2009 Hearing Order.

DBEDT's Opening Brief also provides its response to and discussion of the one legal issue raised in the Commission's July 15, 2009 letter to the Parties transmitting the Commission's post-hearing information requests (IRs).

I. Will decoupling achieve Hawaii's objectives?

Yes. DBEDT believes that a well designed decoupling will help achieve Hawaii's objectives. Decoupling helps remove the barriers to the utilities to aggressively promote and accommodate clean and renewable resources by ensuring utility cost recovery and reducing or eliminating regulatory lag.

The Commission instituted this docket based on the Energy Agreement entered into between the State and the HECO Companies

on October 20, 2008, under the auspices of the HCEI. The intent of the Energy Agreement in supporting the adoption of a decoupling mechanism for the HECO Companies was to remove the barriers to the utility to aggressively pursue and promote demand-side programs (e.g., demand response programs), customer-owned and third party owned energy systems and technologies; and to accelerate the increased use of renewable energy resources in the utility generation portfolio to help transform Hawaii to a 70% renewable energy-based economy by 2030. While the Commission is not a signatory to the Energy Agreement and is not bound by its terms and commitments, the HCEI provides a policy framework for achieving Hawaii's energy objectives articulated in chapter 226-18, Hawaii Revised Statutes (HRS). The Commission is mandated under chapter 269-6, HRS, to consider the need for increased renewable energy use in the exercise of its duties and authority.

HCEI identified decoupling as an important mechanism to help achieve Hawaii's goals given regulatory lag, the impact of HCEI-related initiatives and programs on the utilities' kilowatt-hour sales (such as the institution of the energy efficiency portfolio standards (EEPS)), and the utility's costs in delivering on its commitments in the Energy Agreement.

The Energy Agreement recognizes the need for a financially sound electric utility as a vital component for achieving

Hawaii's independent renewable energy future.² DBEDT notes that the Energy Agreement sets forth the HECO Companies' commitments towards achieving the HCEI goals, and supports a suite of incentives (in addition to a decoupling mechanism) that are subject to Commission approval, such as a purchased power adjustment clause and a clean energy infrastructure surcharge, to provide and facilitate timely recovery of the HECO Companies' investments relating to accelerating and promoting increased use of renewable power generation and other HCEI-related plans and activities. While these other mechanisms are not yet approved by the Commission, they have been considered in HECO's proposed decoupling mechanism by excluding both the costs and the revenues that are (or will be) tracked and recovered through these mechanisms in their decoupling proposal.

DBEDT believes that timely cost recovery is important to enable the HECO Companies to deliver on their commitments in the Energy Agreement that in turn supports the achievement of Hawaii's energy goals. As discussed under subject area III below, DBEDT also believes and strongly recommends that any decoupling mechanism approved by the Commission in this docket must be balanced with protecting consumer interests and ensuring consumer benefits. This may be achieved by including conditions

² Energy Agreement, October 20, 2008, Page 1.

such as target performance goals and service quality and reliability standards.

Hawaii's current regulatory framework through which a utility may recover its costs of providing service is a combination of rate cases, automatic rate adjustment clauses (such as the Energy Cost Adjustment Clause (ECAC)), DSM/IRP surcharge, and other non-base rate adjustments, such as a CEIS/REIP surcharge, and purchased power cost adjustment as may be approved by the Commission.

A rate case proceeding is generally a contested case hearing which takes several months or even years to complete. The length of the proceeding negatively impacts a utility financially, as the recovery of the authorized revenue requirements normally does not start at the beginning of the test-year. Under Hawaii's public utility law, §269-16(d), HRS, the Commission is required to make every effort to complete its deliberations with respect to a public utility's request for a rate increase "as expeditiously as possible and before nine months from the date the public utility filed its completed application." The statute further provides that if such deliberations are not concluded within the nine-month period, the Commission shall render an interim decision within one month after the expiration of the nine-month period. This long regulatory process in evaluating and awarding

a rate increase, also referred to as "regulatory lag", is inherent in the traditional ratemaking process, even with the statutory mandate for expeditious deliberations of rate cases. A decoupling mechanism will help reduce or eliminate this regulatory lag, thereby allowing the HECO Companies more timely cost recovery, and therefore facilitate their ability to deliver on their commitments in the Energy Agreement.

The other important drawback of the traditional ratemaking framework is the link between a utility's earnings (or profits) and its kilowatt-hour sales. This linkage between a utility's revenues (and therefore, earnings) and its kilowatt-hour sales provides financial incentives for a utility to increase, rather than decrease, its kilowatt-hour sales. Any activity or program aimed at achieving Hawaii's energy goals (such as EEPS), customer-sited renewable systems such as net energy metering, demand response programs, and other similar programs undoubtedly negatively impact the HECO Companies' kilowatt-hour sales and are therefore, not aligned with the utilities' financial interest. The connection between a utility's sales and earnings under the traditional ratemaking framework can be seen as a barrier to achieving Hawaii's energy goals, and one which a decoupling mechanism may help remove or eliminate.

A decoupling mechanism de-links or disassociates a utility's revenues (and profits) from the utility's kilowatt-

hour sales, making the utility somewhat indifferent to changes in its sales volume. As discussed in DBEDT's response to the Commission's post-hearing IR-7, some forms of decoupling have been implemented in other states since the 1980's and 1990's to address the financial incentive issue, when the requirement for the utilities' expanded role in designing, implementing, promoting, and delivering demand-side management and conservation programs first began. Most of the decoupling mechanisms adopted in other states are based on the revenue per customer (RPC) method, and most are capped. The results of these earlier decoupling mechanisms in promoting energy efficiency are mixed, or even uncertain. Linking the decoupling mechanism that may be approved by the Commission in this docket to some measurable target performance goals will aid in evaluating the impact of such decoupling mechanism in achieving its intended goals and determining whether or not its continued implementation after the initial two-year period is necessary and useful in achieving the state's goals.

DBEDT believes that an adequately designed decoupling mechanism will help achieve Hawaii's objectives.

II. Decoupling Mechanics: How well does the HECO Companies' decoupling design (RBA) achieve Hawaii's objectives?

The HECO Companies' decoupling design (RBA) guarantees the recovery of the HECO Companies' authorized revenue requirements.

RBA will make utilities indifferent to energy programs and initiatives that impact their kilowatt-hour sales, but may not provide incentives for them to aggressively promote, facilitate, and accommodate increased use of energy efficiency and renewable energy resources.

The HECO Companies and the CA separately filed their initial decoupling proposals on January 30, 2009, pursuant to the PUC order instituting the docket. On March 30, 2009, the HECO Companies and the CA filed a Joint Decoupling Proposal ("Joint Proposal") which adopted the CA's initial decoupling proposal with some modifications agreed to by the two parties. The Joint Proposal has two components: (1) the Revenue Balancing Account ("RBA"), which is essentially a true-up mechanism allowing the HECO Companies to recover their authorized revenue requirements regardless of changes in kilowatt-hour sales; and (2) a Revenue Adjustment Mechanism ("RAM"), which allows for automatic adjustments to the HECO Companies' total revenue requirements based on formulaic determination independent of kilowatt-hour sales, between and outside of rate cases, and essentially serves as a substitute for rate cases in determining revenue increases.

The Joint Proposal's proposed baseline for HECO's decoupling is the revenue requirements approved by the Commission's Interim Decision and Order on HECO's 2009 Test-Year

Rate Case (Docket No. 2008-0083), excluding the revenue taxes and revenues that are separately recovered and reconciled in non-base rates rate adjustments such as the ECAC, DSM/IRP adjustment, and any similar non-base rate adjustments as may be approved by the Commission in the future, such as a purchased power cost adjustment clause, an REIP surcharge, or a CEIS adjustment clause.³ HECO's authorized 2009 test-year revenue requirements were determined under the traditional ratemaking framework whereby the utility petitions for approval of a requested revenue increase with evidentiary support, analysis, studies, testimonies, and responses to information requests by the parties in a rate case docket, including information requests from the Commission and its staff, on any information provided and filed by the utility in the rate case. The Commission makes a determination on the just and reasonable amount of revenue (or rate) increase and the total revenue requirements, including the allowed rate of return on rate base.

By the Interim Decision and Order issued on July 2, 2009, HECO was allowed total revenue requirements of \$1,358,538,000, return on equity of 10.5%, and return on rate base of 8.45%. HECO's revised rates implementing the interim revenue increase became effective on August 3, 2009. The Joint Proposal by the

³The Commission issued its Interim Decision and Order on HECO's 2009 Test-Year Rate Case on July 2, 2009. Docket No. 2008-0083.

HECO Companies and the CA uses these interim authorized revenue requirements, less collected revenue taxes, revenues from non-base rate adjustment clauses, and return on investments, as the baseline for HECO's RBA. The Joint Proposal also indicated that HELCO and MECO will be filing 2010 test year rate cases and proposes to use the interim authorized amounts from these 2010 test year rate cases as the baseline for HELCO's and MECO's proposed RBA.

The proposed RBA component of the Joint Proposal will track the difference between the approved revenue requirements (excluding revenue taxes and revenues from non-base rate adjustment clauses) and the actual collected revenues, and the underage or overages (plus 6% interest) will be added to or subtracted from the following post test-year RAM adjustment to determine the total revenue requirements, thereby arriving at the rate adjustment for the post test-year period.

The RBA-based rate adjustment reflects the "classic" concept of decoupling of revenues from kilowatt-hour sales, and effectively guarantees the recovery of the revenue requirements authorized in the 2009 test-year rate case, regardless of changes in kilowatt-hour sales. The Joint Proposal further proposes to establish the RBA beginning with the effective date of the interim increase. The RBA component of the decoupling mechanism proposed in the JSOP alone could make the HECO

Companies indifferent to the decreases in kilowatt-hour sales that may result from various energy initiatives and policies to achieving Hawaii's energy goals, but may not provide enough incentive for the utilities to aggressively pursue and promote these initiatives, as the RBA simply makes them "whole" by guaranteeing recovery of their authorized revenue requirements. DBEDT does not find anything objectionable to the RBA component of HECO's proposed decoupling mechanism.

In addition to ensuring recovery of their authorized revenue requirements, the HECO Companies also require timely recovery of increases in their costs to overcome the barriers for them to facilitate the achievement of Hawaii's objectives.

III. Revenue Adjustment Mechanism (RAM): How well does it achieve Hawaii's objectives?

As discussed above, another barrier to the utility aggressively promoting and accelerating energy efficiency and adding new renewable energy resources to help achieve Hawaii's energy goals is the regulatory lag inherent in the traditional ratemaking framework. Under the current framework, increases in a utility's costs of providing service in between rate cases are not recovered in its current rates, and this affects the utility's ability to earn a fair return on investment, especially in periods of decreasing sales trends.

The RAM component of the HECO/CA Joint Proposal provides automatic adjustments to the HECO Companies' revenue requirements during non-rate case periods, determined on a formulaic basis. A similar mechanism has been implemented in California.⁴ Briefly, the revenue adjustments are determined by: (1) escalating the HECO Companies' non-labor O&M expense (less fuel and purchased power expense and other costs that are or may be recovered through separate non-base rates surcharges) based on the Blue Chip Economic Indicators Consensus forecast of the Gross Domestic Product Price Index (GDPPI) in January; (2) escalating the HECO Companies' labor expense based on the effective contractual wage rate increase minus a 0.76% productivity offset; and (3) adjusting the recorded year-end net plant-in-service component of the rate base by the estimated plant additions for the period based on the "baseline capital projects" plant additions and the "major capital projects" plant additions net of the calculated accumulated depreciation and accumulated deferred income tax; and contribution-in-aid-of construction (CIAC). The "baseline capital projects" plant additions will be based on the 5-year historic average plant costs additions that are less than \$2.5M recorded in the immediately preceding 5-calendar years that have been placed in-

⁴Most materials on the California decoupling only provide brief descriptions of the various decoupling mechanisms adopted by the CPUC at various times. DBEDT is unable to find an evaluation of the California RAM mechanism that is similar to HECO's RAM proposal.

service. The recorded amounts of these "baseline capital projects" will include the overruns. The "major capital projects" plant additions will include the Commission-approved amounts of capital investment projects ("CIP") that are greater than \$2.5M and are expected to be placed in-service by September of the RAM period.⁵ The revenue adjustment from the rate base adjustment will be determined by multiplying the estimated net-plant in-service additions as determined above, by the authorized rate of return on rate base. According to the CA's illustration of the revenue requirement calculation for the rate base adjustment of the RAM component of decoupling, the percent return on rate base is grossed up to include the revenue tax as well as the income tax component of the return on equity.⁶

The HECO/CA JSOP also includes an earnings sharing mechanism which establishes percentage sharing between ratepayers and the HECO Companies of earned return on equity at various levels above the authorized return.

The second major subject matter in the Commission's Hearing Order relates to the question of how well HECO's proposed RAM will achieve Hawaii's energy goals. DBEDT offers the following observations and proposed modifications to HECO's RAM:

⁵ HECO submittal to the PUC on June 25, 2009, titled "Docket No. 2008-00274-Decoupling Proceeding, Revised and New Exhibits for the Joint SOP", Exhibit C, Page 7 of 12.

⁶ HECO/CA Revised and New Exhibits for the Joint SOP, Exhibit C, Attachment 2, Page 1 of 1. June 25, 2009.

1) The decoupling mechanism proposed by HECO and the CA guarantees revenue increases and recovery, and shifts all the risks from the utility to the ratepayers. The proposed RAM would result in substantial amounts of automatic adjustments to the HECO Companies' revenue requirements during non-rate case years without having to bear the burden of proof on the need for or the reasonableness of such increases, and the RBA component guarantees its recovery. The Commission expressed its concerns during the panel hearings as to whether or not decoupling is reasonable, prudent and in the public interest, especially during these economic times.

Decoupling will undoubtedly result in rate increases. DBEDT believes that with or without decoupling, rates will increase due to the decreases in the utilities' kilowatt-hour sales, not only from energy efficiency and other energy programs, but also because of economic conditions. The difference however is that with decoupling the rate increase will happen sooner than without decoupling. There is also the uncertainty of how much rates will increase without decoupling (through rate cases), whether it will increase higher or lower than would result under HECO's proposed decoupling. The Commission also expressed concern during the panel hearings that even with the refund provision in HECO's RAM proposal is it prudent to overcharge the customers during these economic times.

Given these concerns, the Commission may consider incorporating one or more of the following consumer safeguards into the decoupling design that may be adopted in this case:

- a. Impose a cap on the amount of the total rate increase in between rate cases as was done by other states (i.e., Idaho, Oregon, Washington, Maryland, New York, and Wisconsin) that have implemented a decoupling mechanism.
- b. Impose maximum bounds on the GDPPI or any cost indices as may be approved by the Commission to adjust any cost categories in determining the target revenue requirements adjustments in between rate cases.
- c. Impose a percentage cap on the amount of "baseline capital projects" that HECO proposes to include in the ratebase adjustment component of the proposed RAM. DBEDT notes that HECO's proposed use of the recorded net plant-in-service at the beginning of the RAM year (i.e., Jan 1, 2010 for 2010 RAM year) and the use of the historical average of the recorded "baseline capital projects" costs for the preceding immediate 5-year period (as proxy for the "base plant capital additions" for the RAM year) would reflect the cost overruns twice in the

resulting calculated average rate base for the RAM year.

- d. Exclude or limit the amount of specific major plant capital expenditures (e.g., projects that are contentious like CT-1) from the "major capital plant" costs that HECO proposes to include in the ratebase adjustment component of the proposed RAM.
- e. Impose a percentage cap on the amount of "major capital plant" costs that may be included in the ratebase adjustment component of the proposed RAM.

2) DBEDT finds it imprudent to adopt a decoupling mechanism which guarantees revenue increases and recovery, with the utility not having to bear the burden of proof for the need for and the reasonableness of such revenue increase, and further without ensuring corresponding benefits to accrue to the ratepayers. Linking HECO's proposed RAM mechanism to performance metrics related to Hawaii's energy goals it has obligated itself to help achieve, is necessary, prudent, and in the public interest. DBEDT's proposed performance metrics discussed in its FSOP filed on May 12, 2009, incorporates several measurable performance goals that are within HECO's control, and are based on the HECO Companies' commitments made under the Energy Agreement designed to help achieve Hawaii's goals. To address the concerns and comments raised during the

panel hearings that the RAM is being linked to things that are not yet approved by the Commission⁷ (i.e., feed-in tariffs and PV Host program); DBEDT hereby amends the proposed performance measures to remove those that are based on initiatives that are still pending Commission approval. The amended target performance goals are shown in the following table:

HAWAIIAN ELECTRIC COMPANY, INC. (HECO)				
<u>Performance Measures</u>	<u>Year</u>	<u>Weights</u>	<u>Achieved</u>	<u>Allowed</u>
	<u>2010</u>		<u>Goals</u>	<u>RAM</u>
(A)	(B)	(C)	(D)	(E) = [(D/B) x C]
New Renewable Power From NEM (MW)	5.0	15.00%	4.0	12.00%
New Renewable Power Excluding NEM (MW)	38.5	75.00%	37.0	72.08%
Number of New NEM customers interconnected during the year	300.0	10.00%	300.0	10.00%
Total		100.00%	341.0	94.08%
Total Calculated RAM				\$1,000,000
Total Allowed RAM				\$940,779

The target goals include the addition of new MW from net energy metering; addition of new MW of renewable energy; and the number of new NEM customers interconnected during the year. The table provides the proposed weights for each measure, as well as an

⁷ Panel Hearings Transcripts, Volume III, July 1, 2009, Pages 650-652.

illustration of how the metrics are linked to HECO's proposed RAM.

The proposed performance metrics provide an incentive to HECO to perform and achieve the target performance goals as it determines the amount of RAM that they will be allowed to recover. If HECO achieves all the goals, it is allowed to recover the full RAM amount. If it achieves more than the target goals, HECO may recover more than the full RAM amount, as long as the earnings sharing provision included in HECO's decoupling proposal is also adopted and approved by the Commission. DBEDT believes that achievement of these performance measures are all within HECO's control since they are based on commitments they already made in the Energy Agreement. HECO controls the interconnection standards and procedure for interconnecting net energy metered customers. HECO is also in the "driver's seat" in contract negotiations for purchase power contracts, and controls the success of whether or not a purchase power proposal from a developer actually results in a purchased power contract.

DBEDT's proposal for performance metrics is limited only to HECO for the initial two years, since HECO has the least amount of renewable resources and the largest load to serve. DBEDT recommends that the target amounts for the three measures for 2011 be set at the same levels as the 2010 goals.

Performance Measures	2010 Goals	2011 Goals
New Renewable Power from NEM (MW)	5.0 MW	5.0 MW
New Renewable Power Excluding NEM (MW)	38.5 MW	38.5 MW
Number of New NEM Customers Interconnected	300 Customers	300 Customers

During the panel hearings, there were discussions and concerns raised on the effectiveness of the proposed performance metrics since the HECO Companies can simply file for a rate case whenever they do not get the full RAM amount for failure to meet the performance goals. DBEDT notes that even if the HECO Companies are allowed to recover 100% of the RAM amount, they can still choose to file a rate case. In fact, HECO's proposed RAM includes a two-year rate case cycle. Regardless of whether or not the approval of the proposed RAM is conditioned on target performance goals, there is no guarantee that HECO will not file rate cases less frequently than the two-year cycle plan included in its proposed decoupling mechanism. The desired effect of DBEDT's proposal to link the RAM adjustment to performance metrics is to incentivize the utilities to deliver on their commitments to help achieve Hawaii's goal, as their performance will determine their revenue increase between rate cases. If HECO does not get the full RAM due to non-performance and then resorts to the rate case process to supplement what they did not

get, then decoupling is probably neither appropriate nor necessary in achieving Hawaii's energy goals and the Commission may consider terminating it.

As indicated in DBEDT's FSOP, except for the HECO Companies, there is a general support among the Parties to link the HECO proposed RAM to some performance metrics based on the commitments made in the Energy Agreement, such as proposed by DBEDT. HECO's objection to tie such guaranteed revenue increases and recovery to any target performance measures is based on its claim that performance metrics were not part of the Energy Agreement.⁸ At the same time, HECO claims that they "need to have both the RAM and sales decoupling [RBA] in order to fulfill the state energy objectives..."⁹ These conflicting positions by HECO make it even more imperative for the Commission to condition the approval of any decoupling mechanism on some measurable target performance goals and service reliability measures to protect consumer interests, especially since the proposed RAM removes the process for Commission oversight review of the prudence and reasonableness of the RAM-based increases.

In its response to PUC-IR-30 filed on May 18, 2009, HECO claims that "tying performance metrics to the RAM is

⁸ Panel Hearing Transcripts, Volume III, July 1, 2009, Page 634.

⁹ Ibid. Page 536.

inconsistent with the purpose of the decoupling provision as reflected in the Energy Agreement... [it is] unreasonable and unnecessary." HECO's claim is without merit and absurd. The intent and goals of the Energy Agreement which form the basis of DBEDT's proposed performance metrics are acknowledged and cited in the Commission's Initiating Order which states that the Energy Agreement is "... a comprehensive agreement designed to move the State away from its dependence on imported fossil fuels for electricity and ground transportation, and toward indigenously produced renewable energy and an ethic of energy efficiency. A product of the Hawaii Clean Energy Initiative, the Agreement is a commitment on the part of the State and the HECO Companies to accelerate the addition of new, clean resources on all islands; to transition the HECO Companies away from a model that encourages increased electricity usage; and to provide measures to assist consumers in reducing their electricity bills."¹⁰ (emphasis added). The Order further states that decoupling "... has the benefits of encouraging the substitution of renewable resources, distributed generation and energy efficiency for the utility's fossil fuels production (by reducing a utility's disincentive to promote these types of resources and programs), while simultaneously protecting a

¹⁰ Docket No. 2008-0274, Order Initiating Investigation, October 24, 2008, Pages 1-2.

utility's financial health from erosion as these types of programs go into effect."¹¹

The Commission Order also cited Section 28 of the Agreement which states: "The transition to Hawaii's clean energy future can be facilitated by modifying utility ratemaking with a decoupling mechanism that fits the unique characteristics of Hawaii's service territory and cost structure, and removes the barriers for the utilities to pursue aggressive demand-response and load management programs, and customer-owned or third party-owned renewable energy systems, and gives the utilities an opportunity to achieve fair rates of return."¹² These statements from the Commission's Initiating Order relating to the goals of the Energy Agreement and decoupling support the necessity and reasonableness of linking the RAM to performance metrics as proposed by DBEDT. It also demonstrates the absurdity of HECO's response to PUC-IR-30.

During the panel hearings there were suggestions by the Commission that the "primary goal that we're trying to achieve through decoupling is to make sure that the utility remains financially strong so that the rating agencies continue to look favorably upon this utility." Secondly... "...to extend the time

¹¹ Ibid. Pages 2-3.

¹² Ibid. Page 3.

between rate cases..."¹³ DBEDT agrees with the Commission that these are desired outcomes of decoupling. But DBEDT further contends that these outcomes are desired as a means to help "move the State away from its dependence on imported fossil fuels for electricity and ground transportation, and toward indigenously produced renewable energy and an ethic of energy efficiency ... while simultaneously protecting a utility's financial health."¹⁴

In addition to the above citations from the Commission's Initiating Order, the statement of issues and the major subject areas requiring Commission decisions as stated in the Commission's Hearing Order issued on June 16, 2009, further reiterate that the reasons for a decoupling mechanism for the HECO Companies are to help achieve Hawaii's energy goals as provided in Section 28 of the Energy Agreement cited by the Commission's Order. DBEDT notes that the six major subject matters in the Commission's Hearing Order are stated in terms of how well the decoupling "will achieve Hawaii's objectives".

3) In addition to the necessity and reasonableness of linking the allowed RAM amount to achieving the Hawaii goals, it is equally important and necessary for the consumers' benefit to link the allowed RAM amount to certain service reliability

¹³ Panel Hearings Transcript, Volume III, July 1, 2009, Page 640.

¹⁴ Docket No. 2008-0274, Order Initiating Investigation, October 24, 2009, Pages 2-3.

standards, ensuring that the HECO Companies do not become complacent with maintaining reliable service. In the feed-in tariffs (FiTs) proceeding, Docket No. 2008-0273, DBEDT proposed in its Opening Brief that the Commission require the HECO Companies to submit certain information to help accurately determine the qualifying project size for FiTs rates, including the target service reliability goals for each island in terms of system average interruption frequency (SAIF), and the system average interruption duration (SAID), feeder average interruption frequency (FAIF), feeder average interruption duration (FAID), and any other service quality performance indices that the HECO Companies measure and/or track as a matter of service performance and operations standards.¹⁵ Pending Commission decision in the FiTs docket and absent information on the HECO Companies' service reliability goals and standards, DBEDT recommends to the Commission that the total revenue requirements adjustment (excluding O&M labor, fuel and purchased power costs) for the RAM year be tied to the achievement of the following SAIDI targets for each of the HECO Companies:

COMPANY	SAIDI Target Goals
HECO	110 minutes
HELCO	160 minutes

¹⁵ Docket No. 2008-0273, DBEDT's Opening Brief, June 12, 2009, Page 48.

MECO	135 minutes
------	-------------

DBEDT proposes that for every service interruption lasting longer than the above SAIDI target goals during the year preceding the RAM year, the total target revenue requirements adjustment (excluding O&M labor, fuel and purchased power costs) for the RAM year will be reduced based on the kWh sales that would have been served during the entire outage period. For example, if HECO experienced a service interruption lasting for 120 minutes during the preceding year, the total RAM revenue requirements adjustment will be reduced by an amount equal to the total adjustment expressed on a per kWh basis for the current RAM year (i.e., calculated total RAM adjustment ÷ estimated kWh for the RAM period) multiplied by the estimate of the kWh lost or kWh not served during the entire service interruption period. The lost kWh sales during the service outage will be estimated by multiplying the recorded system kW load at the start of the service outage by the outage duration in number of hours (i.e., 120 minutes ÷ 60 minutes = 2 hours). The target revenue requirements will be reduced by the amount of decrease in the total RAM adjustment. The calculation of the decrease in the total RAM adjustment is illustrated as follows:

$$L1: \text{Total RAM Adj} = (\text{Rev Reqmt on O\&M Non-labor Adj}) + (\text{Rev Reqmt on Ratebase Adj})$$

L2: Avg RAM Adj per kWh = $L1 \div \text{kWh in RAM year}$

L3: Lost kWh during outage = (Recorded System kW Load at start of service interruption) x (outage duration in hrs)

L4: Reduction in Total RAM Adj = $L2 \times L3$

L5: Allowed Rev Reqrmt Adj = $L1 - L4$

In DBEDT's FSOP, we proposed that the evaluation of the continued implementation of a decoupling mechanism must include an assessment of the HECO Companies' operational efficiencies and cost management during the decoupling periods, including an assessment of the service quality as measured by certain service quality indices such as the System Average Interruption Frequency Index (SAIFI), and the System average Interruption Duration Index (SAIDI).¹⁶ Upon further review of the HECO's RAM proposal and of the hearings transcripts, DBEDT believes that linking the allowed RAM amount to service quality standards measured in terms of SAIDI such as discussed and proposed above is one way to balance the benefits of decoupling to the utility with ratepayers benefits and protection in the RAM design. DBEDT's proposal also addresses the question raised by Moderator Hempling on how to address lost revenues due to an outage in the proposed decoupling mechanism.¹⁷ Without decoupling, the utility will not recover lost revenues due to service outages. Under

¹⁶ DBEDT FSOP, May 11, 2009, Page 17.

¹⁷ Panel Hearings Transcripts, Volume III, July 1, 2009, Page 687.

the proposed decoupling, the utility will not suffer the financial consequences of revenues lost due to outages, as the RBA component of decoupling guarantees recovery of the target revenue requirements. DBEDT's proposal provides one method of ensuring that the lost revenues due to outages are not recovered from the ratepayers by adjusting the total RAM revenue requirements adjustment based on the unserved kWh during the outage period. Incorporating the adjustment in the determination of the target revenue requirements is simpler and easier to implement than determining the lost kWh and lost revenues for each rate class during the outage period.

4) As discussed and proposed in DBEDT's FSOP filed on May 12, 2009, the HECO Companies' O&M labor expense should be maintained at the approved level in the utility's last rate case in the determination of the RAM revenue requirements adjustment. A guaranteed pass-through of labor cost increases at the current contractual wage rate increase as proposed in the HECO/CA Joint Proposal could very likely eliminate the utilities' incentive to prudently manage their labor costs through the contract negotiations with the union. Furthermore, to automatically pass through HECO's current contractual labor wage increase of 4.5%¹⁸ to the ratepayers, especially during these economic times when

¹⁸ HECO/CA Revised and New Exhibits for the Joint SOP, June 25, 2009, Exhibit C, Attachment C, Page 1 of 3, footnote N.3a.

unemployment is high and increasing, is not prudent, it is unreasonable, and it is not in Hawaii's best interest.

5) If the Commission adopts a decoupling mechanism for the HECO Companies, the Energy Cost Adjustment Clause (ECAC) should be modified as proposed in DBEDT's FSOP, such that the "efficiency incentive" currently built into the ECAC calculation through the use of a fixed efficiency factor is either eliminated or modified. As discussed earlier, the Commission's Initiating Order cited the Energy Agreement as the basis for instituting this docket. DBEDT notes that the basis for the Energy Agreement's support for implementing a decoupling mechanism is to remove the barriers to the utilities to help achieve Hawaii's goals. Embedding a utility incentive in a cost recovery mechanism for fossil-based generation would continue to perpetuate the utility's incentives to use fossil fuel-based generation, which is neither consistent with Hawaii's energy goals nor in the public interest.

As discussed in DBEDT's response to the Commission's post hearing IR-13 filed on August 24, 2009, the built-in incentives in the ECAC calculation provide disincentive for the utilities to integrate and add renewable power generation, especially variable or intermittent renewable generation, in the system, as such addition would require the utility to run higher amounts of spinning reserve (or regulating reserve) which is more costly

since these units must operate at lower output levels where efficiency is lower.¹⁹ Therefore, the fixed heat rate in the ECAC calculation could incentivize the utilities to run their units more efficiently and reduce variable renewable generation in the system (i.e., less renewable energy purchases or increased curtailment of purchased renewable power), thereby perpetuating the utilities' dependence on imported fossil fuels, which is not in Hawaii's best interest. It will further incentivize the utilities to hold on to their aging fossil fuel-based central generating legacy systems rather than moving toward renewable distributed energy systems.

If the Commission wishes not to eliminate the use of a fixed efficiency factor in the ECAC calculation, DBEDT recommends that the determination of the fixed efficiency factor be modified. This fixed efficiency factor is normally determined and set in the utilities' general rate case. The calculation of the current fixed efficiency factors in the HECO Companies' ECAC is illustrated in HECO's Response to PUC-IR-43, Attachment 1.²⁰

First of all, DBEDT recommends that if the Commission adopts a decoupling mechanism, the fixed efficiency factors should be revised and updated effective the same date as the

¹⁹ DBEDT Response to PUC-IR-13, August 24, 2009, Pages 36-37.

²⁰ HECO Companies' Responses to Information Requests, PUC-IR-43, Attachment 1, June 22, 2009.

decoupling mechanism, rather than waiting for the utilities' rate cases. Second, the calculation of the fixed efficiency factors as illustrated in HECO's Response to PUC-IR-43 must be modified such that these factors are calculated using the kilowatt-hours at the net generation level (resulting in lower heat rate value which means higher efficiency) rather than using the kilowatt-hours at the sales level (resulting in higher heat rate value which means lower efficiency). For instance, HECO's Response to PUC-IR-43, Attachment 1, Page 2, shows the calculation of the fixed heat rate used in HECO's current ECAC which was set in HECO's 2005 test year rate case. DBEDT recommends that the fixed efficiency factor should be set at the calculated heat rate of 10,602 Btu/kWh at the net generation level shown in Line 4, Column D, rather than converting such value at the sales level as calculated in Line 9, Column A, which results in a higher heat rate value (worse or lower efficiency) of 11,140 Btu/kWh as used in HECO's current ECAC.

The "sales level" heat rate reflects lower efficiency (i.e., higher heat rate value means lower efficiency) than the heat rate at the "net generation level" (lower value which is better efficiency), because the total fuel (in MBtu) which is based on the actual recorded efficiency (MBtu/bbl) of the utilities' generation units is divided by the lower sales level kilowatt-hours. Setting the fixed efficiency factor at the

higher sales level heat rate value (11,140 Btu/kWh) instead of the lower heat rate value at the net generation level (10,602 Btu/kWh) which reflects the actual recorded heat rate, means that the resulting difference in the amount of fuel actually used at the higher efficiency (10,160 Btu/kWh) and the amount of fuel cost allowed to be recovered at the lower efficiency (11,140 Btu/kWh) represents the amount of fuel cost savings that the utility is allowed to keep.

DBEDT's proposal to set the fixed efficiency factor at the net generation level more accurately reflects the actual efficiencies of the utilities' generation units. By basing the ECAC calculation on the higher efficiency factor calculated at the net generation level (lower heat rate value), DBEDT believes that the utilities will not only continue to efficiently maintain and run their generation but will likely be incentivized to increase their units' efficiency even higher, so as not to incur higher fuel expense than they are allowed to recover in the ECAC. This would benefit both the utilities and the ratepayers as it results in lower fuel costs. More importantly, this incentive structure proposed by DBEDT is aligned with Commissioner Kondo's suggestion during the hearing to provide incentives in terms of penalties for substandard

performance²¹ (i.e., if HECO does not efficiently maintain and run its generation units, it will incur higher fuel costs than it is allowed to recover).

IV. Revenue per Customer Mechanism and Other Alternatives: How Well Do They Achieve Hawaii's Objectives?

Revenue adjustment mechanisms such as the revenue per customer (RPC) method supported by Hawaii Design Analysis ("HDA") in its FSOP filed on May 11, 2009, and the RAM component of the decoupling mechanism proposed in the HECO/CA JSOP, are alternative methods of providing timely cost recovery. These mechanisms allow for automatic adjustments to a utility's revenue requirements outside of a general rate case, without the utility bearing the burden of proof for the need for, or the reasonableness of the amount of, an increase. A major concern and issue is whether any of these mechanisms will result in "just and reasonable" increases in the HECO Companies' revenue requirements and achieve Hawaii's objectives.

The RPC method increases a utility's revenue requirements in between rate cases based on the number of customers. The determination of the revenue adjustment under this method is based on pre-determined revenue per customer, which is normally set in a general rate case under the traditional ratemaking

²¹ Panel Hearing Transcripts, Volume III, Page 608, July 1, 2009.

framework, multiplied by the number of customers during the non-rate case period. For a utility with an increasing customer base, RPC may be an effective mechanism for a timely cost recovery of the increases in costs, assuming that the increases in costs are due mainly to the increase in the number of customers served. In situations where the increases in costs are far greater and increasing at a faster rate than the increases in the number of customers, or where the customer base is decreasing rather than increasing, the RPC method may not provide enough rate relief to recover the increases in the utility's costs.

RPC was the most common revenue adjustment mechanism used by states that have implemented decoupling, as shown in Attachment 1 (Revised 2/3/09) of the HECO Companies' Revenue Decoupling Proposal filed with the Commission on February 24, 2009. According to the information provided by HECO, RPC was used or is still being used by a total of 17 states, including Arkansas, Colorado, Florida, Idaho, Illinois, Indiana, Maryland, North Carolina, Maine, New Jersey, New York, Ohio, Oregon, Utah, Virginia, Washington, and Wisconsin. Eight of these states implemented RPC for electric utilities (including gas & electric companies), and four of these states still have the RPC mechanism in place.

Revenue adjustment mechanisms which escalate all or selected cost items based on some cost indices present another method of providing automatic increases to a utility's revenue requirements as a proxy for traditional ratemaking. The revenue adjustment mechanisms raised in the Commission's post hearing information requests to the Parties (IRs 3a, b, and c) issued on July 15, 2009, are examples of "targeted" revenue adjustment mechanisms, and are variants of the HECO/CA RAM proposal. These mechanisms provide for increases in only certain specific cost categories, such as those related to system reliability, plant additions related to customer additions, or costs associated with complying with Act 155. As discussed in DBEDT's response to the Commission's post hearing information requests filed on August 24, 2009, each of these mechanisms will most likely result in a lower rate increase impact relative to the HECO/CA RAM proposal. The downside of these targeted revenue adjustment mechanisms is the difficulty of determining the costs that qualify to be included under these categories. Adopting any one of these targeted revenue enhancing mechanisms requires a clear and transparent definition and guidelines from the Commission on what costs qualify under each classification to ensure that there is no double counting or double recovery of any cost item, and a clear and transparent reporting requirement from the utility. DBEDT also noted that adopting all three mechanisms

plus RPC could result in double recovery of certain costs items and may over-compensate the utilities.²²

An alternative or complementary mechanism to decoupling is the utilities' rate design. The HECO Companies' current rate design is one of the barriers to the utilities in accelerating and aggressively promoting energy efficiency as well as increasing use of renewable energy systems, because of the amount of fixed costs recovered through the volumetric rates (or energy rates). The greater the amount of fixed costs in the energy rates, the greater the resistance of a utility to promote activities or programs (i.e., DSM programs) that decrease their kilowatt-hour sales.

As discussed during the panel hearings, decreases in kilowatt-hour sales result in unrecovered fixed costs that are embedded in the volumetric charges. DBEDT defines volumetric rates as the energy rate component in the HECO Companies' rate design, which is the rate charged on kilowatt-hour sales. In HECO's response to question #1 of the NRRI Scoping Paper, the utility posits that the HECO Companies recover approximately 91% of their fixed costs through "volumetric charges" which HECO defined in the instant docket to include both the energy rates (which are based on kilowatt-hour sales) and demand charges

²² DBEDT's Responses to the PUC's Post Hearing Information Requests, DBEDT Response to PUC-POST-HEARING-IR-12, Pages 33-34, August 24, 2009.

(which are based on some measure of the customer's kilowatt demand).²³ While DBEDT agrees that decreases in kilowatt-hour sales result in lost fixed cost recovery, DBEDT does not agree with HECO's estimate of the amount of fixed costs embedded in the volumetric rates and are therefore not recovered when kilowatt-hour sales decrease. During the hearing, DBEDT observed that the HECO Companies' estimates of the lost fixed costs recovery provided in this docket differ from the estimates HECO provided in the feed-in tariffs proceeding, Docket No. 2008-0273, as well as the fixed cost used in calculating the supposed subsidy reported in the Net Energy Metering Status Report filed by HECO with the Commission on January 9, 2009.²⁴ DBEDT believes that providing accurate information is important and necessary to help the Commission in its deliberations.

DBEDT and HECO have differing positions on whether HECO loses its fixed costs recovered through the demand (kilowatt) charges when kilowatt-hour sales decrease. DBEDT's position is that the amount of lost fixed cost due to decreasing sales includes mainly the amount of fixed cost embedded in the energy rates, and this is consistent with HECO's calculation of the lost fixed cost used in calculating the supposed subsidy filed in its January 9, 2009 NEM Status Report. DBEDT believes that

²³ HECO's Responses to Questions in Appendix 2 of the NRRI Scoping Paper, February 20, 2009, Page 8 of 10.

²⁴ Panel Hearing Transcripts, Volume I, Page 124.

decreases in kilowatt-hour sales do not necessarily lead to decreases in lost revenues from HECO's demand charges for the following reasons:

- a) The demand charge is applied to the customer's kilowatt demand, which is a function of the customer's connected load to the system, and which is not as "variable" as a customer's kilowatt-hour usage, since changing its connected load normally requires capital investment. For instance, a customer with a customer-sited renewable system (e.g., net energy metered customers) will normally not disconnect its connected load to the system and that connected load will draw power from the system when the customer-sited system is not producing power.
- b) The HECO Companies' demand charge includes a ratchet provision which calculates the billing demand on which the demand charge is applied by looking at both the customer's maximum kilowatt demand for the current billing period and its maximum demand for the prior eleven months. This provision is a revenue recovery feature embedded in the design of HECO's demand charges.

The post hearing supplemental information submitted by DBEDT to the PUC on July 13, 2009 showed that the proportion of the HECO Companies' fixed costs recovered through the volumetric charges (or energy rates) under present rates ranged from 20%

for HECO (excluding Schedules DS and P)²⁵ to 46% for HELCO. These estimates are much lower than HECO's estimates of over 90% lost fixed costs recovery. Under the HECO Companies' proposed rates in their respective rate cases pending before the Commission, the proportion of total fixed costs embedded in the volumetric rates (or energy rates) ranged from 65% for HECO to 81% for Molokai. The increase in the proportion of fixed costs embedded in the energy rates under the HECO Companies' proposed rates indicates that the utilities' rates are moving away from, rather than closer to, costs of service. Put another way, the proposed rates are less aligned with the cost of service than the present rates, which could have unintended consequences not only on the fixed cost recovery, but also on the impact on customers within a rate class.

Aligning rates with costs has been one of the HECO Companies' rate design objectives for many decades. Cost-based rate design could help reduce or minimize the lost fixed cost recovery and therefore help reduce the need for or the impact of a decoupling mechanism. Generally, changes in the rate design are normally proposed and evaluated in the HECO Companies' rate case filings. Given the changing kilowatt-hour sales trend and the necessity of achieving the state's energy goals for public

²⁵ Breakdown of revenues by rate components for these rate classes at HECO's present rates is not available. DBEDT's Submission of Supplemental Information, July 13, 2009.

benefit, DBEDT recommends that the Commission consider opening a docket to re-examine and evaluate the utilities' cost of service study methodology; how to align and use the rate design in achieving the State's energy goals while ensuring the utility's cost recovery and financial integrity; and evaluate other rate options and rate offerings that would encourage energy efficiency, load management, and facilitate customer-owned generation.

DBEDT believes that while decoupling may remove the disincentives for the HECO Companies to promote and accelerate demand side programs and the addition of new renewable energy to its systems, it should be complemented by cost-based and innovative rate design such as time-of-use rates, to minimize not only the need for decoupling, but also to reduce its impact. Standby service rates are another rate option that will help promote Hawaii's goals without necessarily resulting in lost fixed cost recovery, if designed appropriately. DBEDT therefore recommends that the Commission initiate a generic docket to investigate rate design and rate re-structuring for the HECO Companies.

V. Energy Cost Adjustment Clause Amendment: What are its Advantages and Disadvantages in Terms of Hawaii's Objectives?

Several parties in the instant docket, including DBEDT, advocated making the ECAC a full cost recovery mechanism and eliminating the efficiency incentive embedded in the ECAC calculation, if a decoupling mechanism is adopted by the Commission. This incentive mechanism in ECAC results from the use of a fixed heat rate or efficiency factor in the ECAC calculation which is set during a rate case. The CA and the HECO Companies claim that this fixed heat rate in the ECAC calculation provides an incentive to the utilities to operate their generating units efficiently.²⁶ This is achieved by the utilities performing regular and consistent maintenance of their generating units to keep them running efficiently. The fuel savings are kept by the utilities, but the costs will be automatically passed through to the consumers under the proposed RAM, including any cost increases without Commission review.

As evident in HECO's response to the Commission's post hearing IR-53, and discussed by DBEDT in subject matter III above as well as in DBEDT's response to PUC-Post-Hearings-IR-13 filed on August 24, 2009, this built-in "efficiency incentive" in the ECAC calculation could provide disincentives for the

²⁶ Docket No. 2008-0274. Joint Final Statement of Position of the HECO Companies and Consumer Advocate, May 11, 2009, Exhibit D, Page 1.

utilities to integrate or add renewable power generation in the system. The addition of renewable power, especially variable or intermittent renewable generation, would require the utility to run higher amounts of spinning reserve (or regulating reserve) which is more costly to run as these units must operate at lower output level where efficiency is lower.

DBEDT's response to the PUC-Post-Hearing-IR-13 also provided the pros and cons of adopting a "dead band" around the fixed efficiency factor as proposed by the CA and the HECO Companies in their JSOP filed on May 11, 2009. Essentially, DBEDT does not believe that adopting such proposed dead band around the fixed efficiency factor will address the concerns raised regarding the embedded incentive in the ECAC.

If the Commission does not wish to eliminate the fixed heat rate to allow a full pass-through of energy costs through the ECAC, DBEDT recommends instead to modify the determination of the fixed heat rate used in the ECAC, as discussed in subject matter III above. Essentially, DBEDT's recommendation is to set the fixed heat rate to more accurately reflect the actual recorded heat rates of the HECO Companies' generating units.

VI. What review processes and safeguards should the Commission consider?

The issue of appropriate review processes and safeguards to be instituted with regard to the implementation and ongoing

monitoring of whatever decoupling mechanism the Commission may adopt should not be analyzed or decided in a vacuum. Obviously, settled legal and policy principles that are traditionally brought to bear with respect to any Commission decision, such as fairness and reasonableness, prudence, security (including financial viability of the utility), and the like will always find their relevance and application. In this particular docket however, the type of review and the nature of the safeguards relevant to decoupling must be conceived within the greater context of why a decoupling mechanism proposal is before the Commission in the first place: what ends it is meant to serve and therefore what parameters the Commission may reasonably impose guided by those ends.

DBEDT recognizes that there are a number of dockets open before the Commission at this time, all conceived to work together to render this State's policy goal of increased use of renewable energy (and a commensurate or greater decrease in the use of fossil fuel-fired generation) a reality.²⁷ The HCEI Agreement, far beyond any narrowly posed or easily answered legal question of its binding effect on the Commission, other parties to this docket, or even the signatories themselves, is a clear attempt by the State and the HECO Companies to effect a

²⁷ These dockets include Intragovernmental Wheeling [2007-0176]; Feed-in Tariffs [2008-0273]; PV Host [2009-0098]; CESP [2009-0108]; and of course the instant docket, Decoupling [2008-0274].

system of combined programs, new regulatory frameworks, and new premises leading to one such common goal: to achieve energy independence and security with its attendant economic and environmental benefits. DBEDT believes that it is then within this context that the Commission must consider how to review the operation and success of decoupling: adopting processes that measure just how closely the decoupling mechanism adopted is doing its part in the larger program toward delivering the State into its renewable future.

The current Joint Proposal is structured such that the greatest opportunity for departure from just and reasonable rates is within the RAM component. The proposed RAM was never conceived to be a method for prudent cost recovery. It affords the utility a measure of security and the promise of fewer rate cases, but at a price: it constitutes a virtual shortcut around the traditional ratemaking process (with all of its attendant safeguards and procedures), thus potentially exposing the ratepayers, in the interim years, to imprudently incurred costs affecting rates, among other things. Even if there are processes proposed to deal with those concerns, the RAM still poses a threat to the longer-term goals of increased renewable energy use (and decreased oil use) if left unchecked. Since the very purpose of the introduction of the concept of decoupling was to remove the utilities' barriers to achieving this goal, it

becomes a rational imperative to create a review process that reflects the utilities' progress toward this goal, and to consider what steps are to be taken if such progress is off track, or even ahead of schedule. The performance metrics, however they may be modified in the Commission's discretion, are necessary.

In its FSOP filed on May 12, 2009, DBEDT also suggested several implementation issues that should be reviewed in the reporting and evaluation of any decoupling mechanism that may be approved by the Commission in this docket, including but not limited to the following:

- 1) Assessment of any unintended consequences of the adopted decoupling mechanism, such as increasing rate volatility and uncertainty, including significant rate increases. DBEDT strongly recommends that the Commission require the utility to provide clear and transparent reporting and analysis of the RAM-based revenue requirements adjustments and the actual recorded increases in the utility's costs for each RAM year, to determine whether the resulting adjustments to RAM revenue requirements are reasonable given the HECO Companies' actual incurred expenses.
- 2) Assessment of the use of a future test-year in rate case proceedings with the decoupling mechanism. This issue is important since decoupling is a proxy for determining

future costs increases, and the use of a future test-year in rate case proceedings is to determine the utility's revenue requirements representative of future year's conditions; using the authorized revenue requirements based on future test-year as the base for the decoupling mechanism could or would overstate the revenue requirements adjustments and overcompensate the company.

- 3) Assessment of adopting caps in addition to linking RAM to performance metrics, if decoupling is re-authorized by the PUC to continue - such as suggested earlier under subject matter III, to protect the ratepayers' interests.
- 4) Assessment of whether the decoupling adopted in this docket provides utility incentives that actually support and promote energy efficiency and conservation, especially since these programs are no longer administered by the HECO Companies, and whether the need for decoupling is lessened with the transfer of the programs to the Public Benefits Administrator.
- 5) Assessment of HECO's achievement of its commitments under the Energy Agreement as indicated by such activities as the number and amount of purchased power contracts applications filed with the Commission for approval, the number of net energy metered customers interconnected to the system,

increases in the achieved RPS as reported in its annual RPS Report to the Commission, and other similar activities.

- 6) Assessment of the HECO Companies' operational efficiencies and cost management during the decoupling periods as indicated by such measures as the labor expense per kilowatt-hour sales, changes in the utility's generation heat rates, proportion of administration costs (i.e., A&G expense) to total O&M costs (and total labor costs), changes in the maintenance expenses, increases in labor overtime costs, increases in overhead costs, increases in customer complaints, increases in uncollectibles (or uncollected revenues), increases in service terminations due to non-payment of bills, and other similar operational efficiency measures.
- 7) Assessment of any changes in the service quality as measured by certain service quality indices such as, but not limited to, the System Average Interruption Frequency Index (SAIFI), and System Average Interruption Duration Index (SAIDI).
- 8) Assessment of the administration costs of the decoupling mechanism as compared to those of traditional rate cases.

VII. Legal Issue: Is it lawful for the Commission to impose a decoupling charge on customer categories that have reduced their consumption, while granting a decoupling credit to customer categories that have increased their consumption, given the state policy of inducing a reduction in consumption? Please also discuss the advantages and disadvantages of allocating the decoupling charge based on increases, rather than decreases, in a customer category's consumption.

Yes. Under chapter 269-16(b)(2)(A), Hawaii Revised Statutes (HRS), it is lawful for the Commission, after a hearing and by order, to impose rates, classifications, charges, and practices, as long as they are just and reasonable. Even if such rates or charges may appear arguably discriminatory in some manner, the statute only prohibits *unreasonable* discrimination, not discrimination of all kinds (see, for instance, section 269-16(b)(2)(B)). Whether a charge such as the decoupling charge, either as set forth in the HECO Companies' Joint Proposal or as mentioned in the second part of this question, would be found to be unreasonably discriminatory would turn again on the general principle of chapter 269, that the Commission's authority in this area is limited to just and reasonable ratemaking.

The statute itself sheds some light on what express exercises of Commission authority are deemed just and reasonable. For instance, section 269-6(b), HRS, mandates that the Commission "may consider the need for increased renewable energy use in exercising its authority and duties under this chapter." This means that the Commission, in determining the

decoupling charge under its regulatory and ratemaking procedures authority conferred under section 269-16, HRS, may, consistent with just and reasonable practices, consider reversing the HECO Companies' proposal for purposes of advancing the need for increased renewable energy use.²⁸ In other words, as premised in the legal question, the Commission may adopt a true-up mechanism such that a rate class that reduced its energy usage (presumably due to conservation or energy efficiency) and thereby showed an under-recovery of its assigned target revenue requirements will be given a rate decrease adjustment (or credit), while the rate class that increased its energy usage and showed an over-recovery of its assigned target revenue requirements will be given a rate increase adjustment.²⁹

On the other hand, there is nothing in the statute that absolutely requires fixing rates and charges to appear transparent with respect to the State's renewable energy policies. As long as there is a reasonable rationale that satisfies the "just and reasonable" standard, the Commission clearly retains its authority to set rates and charges as it sees fit, after due process and a hearing.

²⁸ This reasoning is evidently one of the premises behind this question as phrased to the Parties.

²⁹ Other instances in the Hawaii statutes which grant authority for seemingly discriminatory ratemaking in the name of furthering public policy include section 269-26.5(a) [preferential water rates for agricultural activities]; and section 269-121(a), (b) [authorizing the Commission to place demand-side management surcharge collections into energy-efficiency programs through the public benefits fee].

What the Commission must grapple with here is thus not a legal question, but a decision fraught with policy implications. As is confirmed in the record,³⁰ the HECO Companies have advanced their currently contemplated plan of assessing a decoupling charge for the customer group that pays in less than target revenue for the year³¹ (and assigning a credit to the customer group that pays more than target revenue for the year) because it is a familiar result of standard ratemaking orthodoxy as found in, for instance, rate cases and DSM charges. This correspondence alone may save the HECO Companies' decoupling charge proposal from being held unreasonable (and hence unlawful) on its face.

The advantage of allocating the decoupling charge based on increases, rather than decreases, in a customer category's consumption (again assuming that revenues attributable to a given customer group being above the year's revenue balancing account target means that the group's "usage" has in fact increased and is not an artifact of the group's constituency, sudden additions to the group, or increased usage in non-efficiency related, yet still renewable, energy) is that the

³⁰ *Passim* and, e.g., in transcript of Panel Hearings, vol. II at p. 262.

³¹ One should bear in mind however that there is a subtle difference between a group "reducing its consumption" in a given year (as this question is phrased) and simply being responsible for less than the target amount of revenue for a given year, inasmuch as that figure will be based on data collected in the last rate case and need not represent an absolute reduction in use *per se*.

rationale employed is consistent with the State energy policy. It would reward the group that exhibits the praiseworthy behavior and thereby conforms to everyone's general understanding of a just and reasonable charge. A disadvantage of adopting this approach would be that it might pose more administrative difficulty on the Companies if the rest of their proposal, including the setting up of the RBA and RAM, were maintained. Matching across accounts and groups, especially when there are more than just two groups (and there are more than two groups) would call for some seemingly arbitrary or at least complicated decisions and procedures to assure fairness. This may lead to other legal issues that have to this point remained un contemplated, making the original proposal preferable even though seemingly not in consonance with the State's policy goals.³²

CONCLUSION

DBEDT believes that a well designed decoupling will help achieve Hawaii's objectives. Decoupling helps remove the

³² Whether the desired economic or policy "signal" communicates through the customer group to the actual individual is still a topic for some debate, and depending on its ultimate disposition could lead to at least a partial rejection of the premise of the question (i.e., penalizing the group that pays in revenues above the RBA target as a group translates the appropriate signal to individual behavior; even an individual who might on a case by case basis actually realize a billing reduction). Such occurrences are not impossible and hence pose another disadvantage to the opposite approach to the decoupling charge mentioned in the second part of this question.

barriers to the utilities to aggressively promote and accommodate clean and renewable resources by ensuring utility cost recovery and reducing or eliminating regulatory lag. The HECO Companies and the CA's decoupling design is a two-part decoupling that delinks revenues (and profits) from kilowatt-hour sales (RBA), and provides automatic recovery of costs increases determined on formulaic basis (RAM). The joint proposal is essentially a proxy or substitute for the traditional ratemaking framework, and removes the Commission review and oversight in determining the utilities' revenue requirements. The mechanism shifts all the risks from the utilities to the ratepayers, making it imperative to ensure that its design includes consumer safeguards and provides consumer benefits.

DBEDT believes that adopting a decoupling mechanism for the HECO Companies may provide reasonable results if such decoupling includes provisions that balance the benefits to the utility with consumer protection and benefits by:

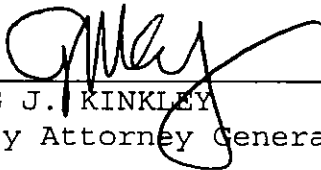
(1) Including adequate consumer protection measures, such as the inclusion of an earnings-sharing mechanism in the RAM design; disallowing the automatic pass-through of the contractual labor wage adjustment in the proposed RAM; and including a service reliability standard in the RAM calculation;

(2) Including provisions that provide measurable results allowing the Commission to quantitatively measure their effectiveness in achieving Hawaii's goals, such as linking the allowed RAM amount to certain measurable target performance goals and service reliability measures;

(3) Complementing decoupling by modification or elimination of the built-in incentive in the current energy cost adjustment clause (ECAC); and

(4) Subjecting decoupling to periodic review by the Commission and allowing for termination by the Commission at any time as deemed appropriate.

DATED: Honolulu, Hawaii, September 8, 2009.



GREGG J. KINKLEY
Deputy Attorney General

Attorney for the Department of
Business, Economic Development, and
Tourism

Certificate of Service

I hereby certify that I have served a copy of the Department of Business, Economic Development, and Tourism's Opening Brief in Docket Number 2008-0274, by electronic transmission on the date of signature to each of the parties listed below.

CATHERINE P. AWAKUNI
EXECUTIVE DIRECTOR
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS
DIVISION OF CONSUMER ADVOCACY
P.O. BOX 541
HONOLULU, HI 96809

DARCY L. ENDO-OMOTO
VICE PRESIDENT
GOVERNMENT & COMMUNITY AFFAIRS
HAWAIIAN ELECTRIC COMPANY, INC.
P.O. BOX 2750
HONOLULU, HI 96840-0001

DEAN MATSUURA
MANAGER
REGULATORY AFFAIRS
HAWAIIAN ELECTRIC COMPANY, INC.
P.O. BOX 2750
HONOLULU, HI 96840-0001

JAY IGNACIO
PRESIDENT
HAWAII ELECTRIC LIGHT COMPANY, INC.
P.O. BOX 1027
HILO, HI 96721-1027

EDWARD L. REINHARDT
PRESIDENT
MAUI ELECTRIC COMPANY, LTD.
P.O. BOX 398
KAHULUI, HI 96732

THOMAS W. WILLIAMS, JR., ESQ.
PETER Y. KIKUTA, ESQ.
DAMON L. SCHMIDT, ESQ.
GOODSILL ANDERSON QUINN & STIFEL
1099 Alakea Street, Suite 1800
Honolulu, HI 96813
Counsel for the HECO UTILITIES

RANDAL J. HEE, P.E., PRESIDENT AND CEO
TIMOTHY BLUME
MICHAEL YAMANE
KAUAI ISLAND UTILITY COOPERATIVE
4463 Pahe'e Street, Suite 1
Lihue, HI 96766-2000

THEODORE A. PECK
ENERGY PROGRAM ADMINISTRATOR
HAWAII DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT, & TOURISM
P.O. Box 2359
HONOLULU, HI 96804

ESTRELLA A. SEESE
MANAGER, ENERGY PLANNING & POLICY BRANCH
HAWAII STATE ENERGY OFFICE
HAWAII DEPARTMENT OF BUSINESS, ECONOMIC DEVELOPMENT, & TOURISM
P.O. Box 2359
HONOLULU, HI 96804

KENT D MORIHARA, ESQ.
KRIS N. NAKAGAWA, ESQ.
MORIHARA LAU & FONG LLP
841 Bishop Street, Suite 203
Honolulu, HI 96813

MR. WARREN S. BOLLMEIER II, PRESIDENT
HAWAII RENEWABLE ENERGY ALLIANCE
46-040 Konane Place, #3816
Kaneohe, HI 96744

DOUGLAS A. CODIGA, ESQ.
SCHLACK ITO LOCKWOOD PIPER & ELKIND
Topa Financial Tower
745 Fort Street, Suite 1500
Honolulu, HI 96813
Counsel for BLUE PLANET FOUNDATION

MR. MARK DUDA, PRESIDENT
HAWAII SOLAR ENERGY ASSOCIATION
P.O. Box 37070
Honolulu, HI 96837

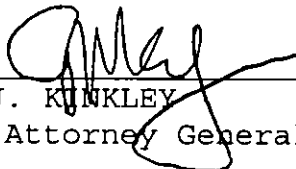
MR. CARL FREEDMAN
HAIKU DESIGN & ANALYSIS
4234 Hana Hwy
Haiku, HI 96708

MR. MIKE GRESHAM
HAWAII HOLDINGS, LLC dba FIRST WIND HAWAII
33 Lono Avenue, Suite 380
Kahului, HI 96732

SCHLACK ITO LOCKWOOD PIPER & ELKIND
DOUGLAS A. CODIGA, ESQ.
Topa Financial Center
745 Fort Street, Suite 1500
Honolulu, HI 96813

GERALD A. SUMIDA, ESQ.
TIM LUI-KWAN, ESQ.
NATHAN C. NELSON, ESQ.
CARLSMITH BALL LLP
ASB Tower, Suite 2200
1001 Bishop Street
Honolulu, HI 96813
Counsel for HAWAII HOLDINGS, LLC, dba FIRST WIND HAWAII

DATED: Honolulu, Hawaii, September 8, 2009.



GREGG J. KINKLEY
Deputy Attorney General

Attorney for the Department of
Business, Economic Development, and
Tourism
STATE OF HAWAII